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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION

REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE EXECUTIVE DIRECTORS
OF THE BANK
AND TO THE
BOARD OF DIRECTORS OF
THE CORPORATION
ON A PROPOSED LOAN
BY THE BANK TO AND
AN INVESTMENT BY THE CORPORATION IN
THE KOREA DEVELOPMENT FINANCE CORPORATION

January 18, 1968

REPORT AND RECOMMENDATIONS OF THE PRESIDENT TO THE
EXECUTIVE DIRECTORS OF THE BANK AND TO THE BOARD OF DIRECTORS OF
THE CORPORATION ON A PROPOSED LOAN BY THE BANK TO AND AN
INVESTMENT BY THE CORPORATION IN THE KOREA DEVELOPMENT FINANCE CORPORATION

1. I submit the following report and recommendations on a proposed Bank loan, in an amount in various currencies equivalent to US\$5 million to the Korea Development Finance Corporation (KDFC) and a proposed IFC equity investment, in an amount of W192.5 million (about US\$713,000), in the same institution.

PART I - BACKGROUND

2. In 1965, the Government requested IFC to help in setting up a private development finance company. An exploratory mission from IFC visited Korea in the fall of 1966 and recommended that a private development finance company should be established. Early in 1967, IFC reached broad agreement with the members of the Federation of Korean Industries (the local sponsoring group) and the Government on plans for the establishment of a company to be known as Korea Development Finance Corporation. Thereafter IFC collaborated closely with the sponsors in establishing KDFC, has assisted in shaping and implementing their plans, and has arranged for the participation of nine private foreign banks in KDFC's share capital.

3. KDFC was incorporated in April 1967 when Korean investors subscribed and paid in W820 million (US\$3.04 million) of share capital. The National Assembly has since passed legislation authorizing the Government to make a long-term subordinated loan to KDFC, and has authorized an agreement regarding repatriation rights in respect of shares subscribed by IFC and the foreign investors.

4. Negotiations took place in Washington between September 18 and 21 and, after a recess for the Annual Meeting, were concluded on October 17, 1967. KDFC was represented by Mr. C. H. Kim, KDFC's President, and the Government by Mr. Moon Doh Chung, Assistant Minister, Economic Planning Board, Mr. C. H. Park, Economic Planning Board, and Mr. K. J. Kim, Second Secretary, Korean Embassy.

5. The proposed loan would be the Bank's first in Korea. In 1962 IDA made a credit for the Korean National Railroad totalling US\$14 million which has been fully disbursed; a second \$11 million credit for the railroad has recently been approved and signed. Within the next few months, I expect to present to the Executive Directors a proposal for a US\$1.5 million technical assistance credit to finance the foreign exchange cost of highway feasibility studies and of studies related to the organization of highway planning and construction, and transport coordination in general. The necessity of these studies was identified by a Bank financed transportation survey carried out in Korea during 1965-66 by consultants.

6. The proposed investment would be the first by IFC in Korea.

PART II - DESCRIPTION OF THE PROPOSED LOAN AND INVESTMENT

7. (a) Bank Loan

Borrower: Korea Development Finance Corporation (KDFC)

Guarantor: Republic of Korea

Amount: US\$5 million equivalent in various currencies

Purpose: To enable KDFC to finance the foreign exchange costs of specific investment projects undertaken by private enterprises in Korea

Amortization: In 30 semi-annual installments beginning on November 15, 1970, and ending not later than May 15, 1985. The Bank and KDFC will from time to time change the amortization schedule to conform substantially to the aggregate of the amortization schedules applicable to KDFC's sub-loans and investments made out of the proceeds of the loan, such schedules not normally to extend beyond 15 years from the time the respective credits are made to the Loan Account.

Interest Rate: When a part of the Loan is credited to the Loan Account, the rate of interest on that part will be the Bank's standard rate for similar loans at that time.

Commitment Charge: 3/4 of one per cent per annum, on amounts credited to the Loan Account

(b) IFC Investment

Amount and Form: IFC will subscribe at the price of par, 38,500 common shares of W5,000 par value each, involving an amount of W192.5 million (about US\$713,000)

PART III - THE PROJECT

8. An "Outline of Proposal for Establishment of Korea Development Finance Corporation (KDFC)", dated January 2, 1968, is attached.

9. The Korean economy is expanding rapidly with industrial production in recent years growing at an annual rate of close to 20%. The existing financial institutions of the country are not adequate to meet the rising demand for industrial financing. At present two Government-controlled institutions, the Korean Reconstruction Bank (KRB) and the Small and Medium Industry Bank (MIB), are the main institutional sources of such financing. KRB is the principal vehicle for providing finance to industrial projects in the public sector, though assistance to the private sector is not excluded, and MIB finances smaller-scale industries. The Government recognizes that a vigorous private sector is important to maintain the present economic momentum and believes that a private institutional source of long-term finance for the private sector will assist that momentum. It therefore fully supports the establishment of KDFC. In the context of the expanding Korean economy, there is a need for an institution such as KDFC and its business prospects are good. The steady growth in Korea's exports of manufactured goods from a few million dollars in 1959 to over \$150 million in 1966, with further increases in 1967, points to a continuing demand for resources to expand the capacity of private industry. Current applications from the private sector for loans from KRB and MIB are far in excess of their lending capacity and the rate of commitment of KDFC's proposed initial resources is likely to be governed more by its capacity to process loan applications than by the volume of business available.

10. KDFC was sponsored by the Federation of Korean Industries, an association of the leading industrial firms, set up to promote the interests of the Korean business community. KDFC's charter defines its scope of operations in broad terms; a Statement of Investment and Operational Policies acceptable to the Bank and IFC and adopted by KDFC's Board of Directors, defines more specifically the scope of intended operations. KDFC will assist primarily the manufacturing and processing industries, through medium- and long-term loans, equity participation and guarantees. Export industries and import-substitution industries will receive high priority. Through its operations KDFC will seek to broaden the ownership of private securities in Korea.

11. KDFC's initial capital resources will be as follows:

<u>Loan Capital</u>	<u>Equivalent in U.S.\$ million</u>	
U.S. Government (AID)	5.0	
IBRD	<u>5.0</u>	10.0
<u>Equity and Quasi Equity</u>		
Korean Government Loan (Subordinated)	7.5	
Authorized Share Capital	<u>5.0</u>	<u>12.5</u>
		<u>22.5</u>

Of the authorized share capital of Won 1,350 million (US\$5 million) an amount of Won 820 million, representing 164,000 shares (about 61%) has already been subscribed and paid in by (i) the members of the Federation of Korean Industries and other private Korean investors (31%); (ii) Korean banks, which are predominantly government-owned (15%); and (iii) Korean insurance companies (15%). Of an additional issue of 106,000 shares, IFC's subscription would be 38,500 shares (about US\$713,000) or 14% of the paid-in capital; four U.S. banks, three European banks and two Japanese banks would take up the remaining 67,500 shares (about US\$1,250,000) or 25% of the share capital.

12. The subordinated Government loan of W2,025 million (about US\$7.5 million) to KDFC was authorized by the Korean National Assembly in October and will be disbursed to KDFC prior to the effectiveness of the proposed Bank loan and of the IFC investment. The loan will be for a period of 40 years (including 10 years grace), carry interest at 4% per annum, and will rank after all other debt and pari passu with the share capital in the event of liquidation.

13. The proposed AID loan, which will be tied to procurement in the United States, will be made to the Government for a period of 40 years (including 10 years grace) with interest at the rate of 2% per annum during the grace period and 2 $\frac{1}{2}$ % per annum thereafter. The Government will relend the proceeds to KDFC for up to 15 years at 6% interest per annum. The loan has already been negotiated and AID proposes to sign the loan at about the same time as the signing of the proposed Bank loan. Effectiveness of the AID loan will be a condition of effectiveness of the proposed Bank loan and of the IFC investment. KDFC has agreed not to incur additional debt in excess of three times its equity, including the subordinated Government loan, without the prior approval of the Bank and AID.

14. KDFC's present Board consists of nine Directors elected by the Korean shareholders. The Chairman of the Board is Mr. C.S. Hong, a leading industrialist and also President of the Federation of Korean Industries. When IFC and the other foreign investors pay in their subscribed capital, four additional directors will be elected representing the non-Korean shareholders. An Executive Committee of the Board of Directors will be established, consisting of four members, including one non-Korean Director, with authority to approve individual investments up to US\$500,000.

15. The sponsors of KDFC strongly expressed the desire that IFC be represented on KDFC's Board, and it is my belief that such representation would be welcomed by the other foreign investors. IFC could make available to KDFC through its representative on the Board, more effectively than by other means, advice and guidance of particular value to KDFC during its early years. IFC's representation would help to strengthen the ties between KDFC and the World Bank Group and would be justified by the size of IFC's proposed investment in KDFC. I propose, therefore, that IFC take a seat on the Board of KDFC.

16. The management of KDFC is judged to be competent and suitable to carry out successfully the operations of a development finance company. The Chief Executive Officer of KDFC, with the title of President, is Mr. C.H. Kim, a former Governor of the Bank of Korea, with long experience in banking. He will be assisted by two Korean Vice Presidents. KDFC has undertaken to employ an advisor with wide experience in finance and investment to assist KDFC's management, and has completed arrangements with Mr. Charles L. Terrel, an American National who is currently Advisor to the National Investment Bank of Ghana, to serve as advisor for two years.

17. KDFC would be able to make sub-loans out of the proceeds of the proposed Bank loan without the prior approval of the Bank up to an aggregate amount of US\$2 million, with an individual project limit of \$100,000.

18. Interest rates in Korea are very high, around 25% per annum for commercial bank loans, reflecting the existing inflationary situation, the intense demand for capital and its high productivity. Initially, KDFC proposes to charge 20% per annum for domestic currency loans and 10% for foreign currency loans with the borrower taking the foreign exchange risk. KDFC's total resources of US\$22.5 million are likely to be committed in about four years. Because of the expected heavy demand for foreign exchange, the Bank's proposed loan and the AID loan are likely to be withdrawn more rapidly than KDFC's own resources. KDFC should become sufficiently profitable to yield a satisfactory dividend in two to three years.

19. IFC's promotional role has been crucial in making the establishment of KDFC possible. Its investment has been the key factor in the decision of the foreign investors to participate. IFC's representation on KDFC's Board will contribute to KDFC's pursuing sound investment policies, to improving opportunities for joint financing of industrial projects in Korea and generally to fostering close relations between KDFC and the Bank Group.

PART IV - THE IFC INVESTMENT

20. The Government has agreed to provide special repatriation rights for 106,000 shares which IFC will subscribe or cause to be subscribed pursuant to a Subscription Agreement to be entered into with KDFC. IFC has obtained commitments from nine private foreign banks to subscribe 67,500 shares and remaining 38,500 shares will be subscribed by IFC. The proposed investment would comply with the IFC's Articles of Agreement.

21. A condition of the subscription will be that KDFC furnish to IFC evidence satisfactory to IFC that the proceeds of all share capital and the subordinated Government loan previously paid to KDFC together with interest earned from the deposit thereof shall be intact, except for interim expenses in an amount satisfactory to IFC.

PART V - BANK LOAN: LEGAL INSTRUMENTS AND AUTHORITY

22. The draft Loan Agreement between the Bank and KDFC, the draft Guarantee Agreement between the Republic of Korea and the Bank and the Report of the Committee provided for in Article III, Section 4(iii) of the Articles of Agreement are being distributed to the Executive Directors separately. The draft Loan and Guarantee Agreements generally follow the pattern of agreements for loans to development finance companies, except that because the KDFC is newly established the commitment charge will be made only on amounts as credited to the Loan Account. The effectiveness of the Loan and Guarantee Agreements would be conditional upon all the other financing being made available to KDFC.

PART VI - THE ECONOMY

23. A report entitled "The Economy of Korea" (FE-55a), dated June 17, 1966, in eight volumes was distributed to the Executive Directors as follows: Volumes I-IV and VI-VIII on June 27, 1966 and Volume V on November 4, 1966. The report noted that the implementation of appropriate fiscal and monetary policies had reduced the monetary instability which marked the years 1962-1964 and had accelerated the growth of capital formation, production and exports. It concluded that the prospects for further rapid growth were favorable provided growth of the domestic savings rate and of financial assistance from abroad continued.

24. An economic mission which recently returned from Korea was favorably impressed by the performance of the Korean economy. The mission's findings are contained in a report entitled "Current Economic Position and Prospects of Korea" (AS 133), dated January 11, 1968, Volume I of which was distributed on January 16, 1968.

25. Economic growth has further accelerated in 1966 and 1967. The increase of the GNP in real terms in 1966 amounted to 13.4% and is expected to be about 10% in 1967. The fastest growing sector is manufacturing where the growth rate has recently been about 20% a year. The rapid growth of manufacturing has contributed substantially to the expansion of total exports, which rose from \$175 million in 1965 to \$250 million in 1966 and probably reached \$350 million in 1967. The phenomenal growth of exports of manufactured products to a large number of developed countries is due to the ability of the Korean entrepreneurs, technicians and workers, and the wholehearted support of the Government.

26. Gross investment has risen from 14.7% of GNP in 1965 to 21.7% in 1966 and has probably been over 22% in 1967. A major part of this increase in investments is being financed by increased domestic public as well as private savings. But despite the improved mobilization of domestic resources the need for foreign capital remains large. United States grant assistance, and low interest long-term loans, mainly from the United States and Japan, are being supplemented by a large amount of foreign supplier's credits. Indebtedness, especially to foreign equipment suppliers, is rising rapidly but is still manageable. Korea can safely accept some additional foreign debt on conventional terms.

PART VII - COMPLIANCE WITH ARTICLES OF AGREEMENT

27. I am satisfied that the proposed Bank loan would comply with the Articles of Agreement of the Bank and that the proposed investment by IFC would comply with the Articles of Agreement of the IFC. The Government of the Republic of Korea has advised that it has no objection to the proposed investment by IFC.

PART VIII - RECOMMENDATIONS

28. I recommend that:

(a) the Executive Directors of the Bank adopt the following resolution:

RESOLUTION NO.

Approval of Loan to Korea Development Finance Corporation
in an amount equivalent to U.S.\$5,000,000 to be guaranteed
by Republic of Korea

RESOLVED:

THAT the Bank shall grant a loan to the Korea Development Finance Corporation, to be guaranteed by the Republic of Korea, in an amount in various currencies equivalent to five million United States dollars (U.S.\$5,000,000), to mature on and prior to the date or dates to be determined as set forth in the form of Loan Agreement (Development Finance Corporation Project) between the Bank and the Korea Development Finance Corporation which has been presented to this meeting, to bear interest at the rate or rates of interest to be determined as set forth therein, and to be upon such other terms and conditions as shall be substantially in accordance with the terms and conditions set forth in said form of Loan Agreement and in the form of Guarantee Agreement (Development Finance Corporation Project) between the Republic of Korea and the Bank, which have been presented to this meeting.

(b) the Board of Directors of the Corporation adopt the following resolution:

RESOLUTION NO. IFC

Approval of Investment in Common Stock of
Korea Development Finance Corporation

RESOLVED:

THAT the Corporation conclude an investment in Korea Development Finance Corporation, Republic of Korea, by subscribing, at the price of par, 38,500 shares of common stock, of par value W5,000 each; and

THAT the President, Executive Vice President or Vice President, or any staff member of the Corporation authorized by any one of them, enter in the name and on behalf of the Corporation into an agreement or agreements providing for such investment and containing such other terms and conditions as he, by the execution thereof, shall approve.

George D. Woods
President

Attachment

January 13, 1968

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OUTLINE OF PROPOSAL FOR ESTABLISHMENT OF KOREA DEVELOPMENT FINANCE CORPORATION (KDFC)

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C U R R E N C Y E Q U I V A L E N T S

US\$ 1.00	=	Won 270
Won 1,000	=	US\$3.70
Won 1,000,000	=	US\$3,703.70

OUTLINE OF PROPOSAL FOR ESTABLISHMENT OF
KOREA DEVELOPMENT FINANCE CORPORATION (KDFC)

Economic Background

1. Korea is rapidly developing from a predominantly agricultural to an increasingly industrial and export-oriented economy. GNP increased at an average annual rate of 4.4% in the late 1950's and 6.3% during the early 1960's. In 1966 real growth attained a rate of over 13% and is expected to be close to 10% in 1967. (Per caput GNP amounted in 1966 to about \$131.) A rapid increase in industrial production, especially for exports, constitutes the main element of the present expansion. Manufacturing production increased at an annual rate of 12% during 1960-1966, but at rates close to 20% in recent years, and accounted in 1966 for 18.1% of GNP and 32.4% of total investment. Korea's exports rose from \$20 million in 1959 to \$250 million in 1966, with manufactured goods, sold to a widening range of markets, accounting for about two-thirds of the total. Industrial investment during the second Five-Year Plan (1967-71) may well reach the official projection of \$1,000 million; the greater part of this investment will be in the private sector.
2. Korea has an energetic entrepreneurial class and a well-educated, well-disciplined labor force. Low-wage, labor-intensive industries such as cheap textiles have tended to migrate to Korea from Japan, with profitable results; and further developments along these lines are expected in the future. Hindrances to industrial development include a scarcity of modern legal and accounting experience.
3. The Government has recognized that a vigorous private sector is important to maintain the present economic momentum and fully supports the establishment of a private development finance company, to operate alongside the two existing Government-controlled industrial financing institutions. These are the Korean Reconstruction Bank (KRB) and the Small and Medium Industry Bank (MIB). Both the Government and the private sector are convinced that a privately owned and controlled development finance company will do much to improve resource allocation and to put industrial finance on a business basis.

Approach to IFC

4. The first request for IFC help in setting up and possibly financing a private development finance company came from the President of the Republic of Korea and the Deputy Prime Minister in 1965. After initial study, IFC sent a mission led by Mr. E. T. Kuiper to Korea in the fall of 1966. That mission recommended that a privately controlled and managed development finance company be established. Thereafter, another mission visited Korea early in 1967 and reached broad agreement with the Government and the sponsors of KDFC on plans for its capital structure, organization and policies. Since then, IFC has collaborated closely with the sponsors and

has given technical assistance in shaping and implementing these plans. IFC has also made arrangements for foreign private participation in KDFC.

Proposal

5. The proposal, as described in the following paragraphs, envisages the establishment of KDFC to be accomplished in two stages. The first stage, the paying in of the share capital by Korean investors, followed by incorporation of the company, was accomplished in April 1967. The second stage of the financing will be completed by the paying in of the Government quasi-equity loan, the paying in of the share capital to be subscribed by IFC and the foreign investors and, simultaneously, the coming into effect of the proposed loans from AID and the Bank.

6. Sponsors. KDFC was sponsored by the Federation of Korean Industries (FKI). FKI is an association of the leading industrial firms, set up to promote the interests of the Korean business community in general and of Korean industries in particular. The Government has given full support, but the burden of promotion and organization was carried by FKI.

7. Legal Basis. KDFC has been set up under the provisions of the Korean Commercial Code as a limited liability joint stock company.

8. Object. KDFC is to provide medium-term and long-term finance to private enterprise in Korea. Government-owned or Government-operated undertakings are excluded, but a Government holding of not more than 15% of the voting stock of a private enterprise does not of itself make such an enterprise ineligible for KDFC financing.

9. Types of Financing. KDFC will be able to invest in any suitable form. It is empowered to underwrite securities, invest in share capital, make medium-term and long-term loans, and provide guarantees, or do any combination of these. The Superintendent of Banks, Bank of Korea, has ruled that the Banking Law does not apply to KDFC.

10. Scope of Operations. KDFC's charter defines its scope of operations in broad and flexible terms. A policy statement (paragraph 18) adopted by the Board of Directors and satisfactory to the Bank and IFC defines more specifically the scope of intended operations. While KDFC's primary field of activity is to be in the manufacturing and processing industries, it may invest also in other types of enterprise, including transport, tourism and large-scale, commercially oriented agriculture. Trade, real estate and small-scale agriculture have been excluded. KDFC is to give due regard to the Government's general economic plans and priorities.

11. Capitalization. At the commencement of business, KDFC's capital resources are expected to be \$22.5 million equivalent, divided as follows:

Share capital	\$ 5.0 million
Government loan (quasi-equity)	7.5 million
Loans	
AID	5.0 million
The Bank	<u>5.0 million</u>
	<u>\$22.5 million</u>

The Government has agreed that KDFC's Won resources to the extent of \$12.5 million equivalent (the sum of the paid-in capital and the Government loan) will be convertible at the request of KDFC into foreign currencies to be utilized in KDFC's loans and investments for the financing of imports.

- a. Share Capital. KDFC's authorized share capital is W 1,350 million (\$5 million), which is to be subscribed (in round figures) as follows in fully paid registered shares of a par value of W 5,000 each:

FKI members and other private Korean investors	W 420 million (\$1.56 million)	31%
Korean banks (predominantly Government-owned)	W 200 million (\$0.74 million)	15%
Korean insurance companies (private)	W 200 million (\$0.74 million)	15%
IFC	W 192.5 million (\$0.71 million)	14%
Foreign investors	W 337.5 million (\$1.25 million)	25%
	W 1,350 million (\$5.00 million)	100%

FKI members and other private Korean investors, together with banks and insurance companies, have already subscribed and paid in W 820 million (\$3.04 million) or 61% of the total proposed capital. They are listed in Annex I. The foreign capital of W 337.5 million (\$1.25 million) will be subscribed by four U.S. banks, three European banks (one British, one German, one Italian) and two Japanese banks. The names of the banks and the amount to be subscribed by each are given in Annex II.

- b. Quasi-Equity. The Government will provide a loan of W 2,025 million, the equivalent of \$7.5 million, which will be channeled to KDFC through KRB. The principal terms of the loan agreement will be the following:
- to be paid in one installment, on execution of the agreement;
 - repayment in 40 years, including 10 years' grace;
 - to rank pari passu with share capital in the event of liquidation of the company;
 - interest payable at 4% per annum;

- v. until KDFC has invested the funds on long term, in accordance with its corporate objectives, the funds will be deposited with KRB bearing interest at 10% per annum. KDFC will withdraw funds from the deposit account, at its request, for long-term investment.

The loan has been authorized by the National Assembly.

c. Loans. Two foreign exchange loans are visualized initially:

- i. From AID, for \$5 million. This will be a "two-step" loan, with AID lending to the Government for 40 years and the Government relending to KDFC for up to 15 years, with a grace period to be determined. The loan to KDFC will carry interest at 6% and disbursements will be tied to procurement in the U.S.A.
- ii. From the Bank, for \$5 million. The Government has agreed to guarantee the loan. The loan would provide KDFC with untied foreign exchange resources.

12. Board of Directors and Executive Committee. The Board is responsible for overall policies and operations. At the Inaugural Meeting of the shareholders held on April 20, 1967, nine directors were elected, representing the Korean shareholders. Later the same day, at the first meeting of the Board of Directors, Mr. C. S. Hong, President of FKI, was elected Chairman of the Board. His curriculum vitae is attached as Annex III. The names of the Directors are given in Annex IV. At or before the completion of the second stage of financing, four additional directors will be elected, representing the non-Korean shareholders. The directors' terms of office will be two years, but the terms of six or seven directors, as the case may be, will expire each year. The Board will be composed as follows:

The President of KDFC	1	
FKI members and other private shareholders	5	
Banks and insurance companies	<u>3</u>	9
IFC	1	
Foreign shareholders	<u>3</u>	<u>4</u>
		<u>13</u>

This composition will be set forth in a voting agreement among the shareholders. Each group will be free to choose its own representatives.

13. A member of the Board having a direct or indirect interest in an investment proposal will declare his interest and will not vote on the proposal. Except for amendments to the policy statement (see paragraph 18 below), Board decisions will be taken by a majority of all Directors.

14. The Board will meet around four times a year, but not less often than twice a year. It will delegate certain powers (mentioned below) to an Executive Committee of the Board consisting of four persons, as follows:

The Chairman of the Board, or another director
representing FKI members and other private
Korean shareholders (or alternate)

The President of KDFC (or alternate)

One Board member representing Korean banks
and insurance companies (or alternate)

One Board member representing non-Korean
shareholders (or alternate)

Alternates have to be appointed from among the Board members. The Executive Committee will have authority to approve individual investments up to \$500,000 equivalent. Its decisions will be taken by majority vote, but any member of the committee may request that a matter be referred to the Board for decision. Investments over \$500,000 equivalent will need the affirmative recommendation of the Executive Committee and will then be submitted to the Board.

15. Chief Executive Officer and his Advisor. The Board of Directors at its first meeting held on April 20, 1967, elected Mr. C. H. Kim, a former Governor of the Bank of Korea, to the position of chief executive officer of KDFC with the title of President (Representative Director in terms of the Korean Commercial Code). His curriculum vitae is attached as Annex V. He will have the powers conferred by the Articles of Incorporation and delegated by the Board. Investment proposals will be considered by the Executive Committee and the Board only after the President has considered them and is prepared to report on them.

16. KDFC will employ a suitable advisor to assist in the management of its business. It is understood that this will be for at least three years and that it will be continued until KDFC and the Bank agree otherwise. The advisor's terms of reference will assure that he plays a significant role in the conduct of KDFC's affairs by having access to staff and files, and by having the right to participate as an advisor in project appraisals, investment decisions, and the deliberations of the Board.

17. Staff. The President will be assisted by two Vice Presidents. The President visualizes, to start with, a staff of about 20, grouped in four departments: Operations, Technical Appraisal, Administration, and Planning and Research. Some staff members have already been recruited, drawn from FKI, KRB, Bank of Korea and other institutions. The U.S. Government AID mission in Korea has sponsored and financed visits by some officers of KDFC to various development banks in Asia.

18. Investment and Operational Policies. Attached as Annex VI is the Statement of Investment and Operational Policies which will guide KDFC's work. It was adopted by resolution at the second meeting of the Board of Directors held on April 25, 1967. These policies provide that KDFC will make its investment decisions on the basis of sound investment criteria; will diversify its loans and investments; will turn over its portfolio as it can; will not take a controlling interest in any enterprise it finances; will limit its debt to prudent amounts; will lend and invest in a manner best calculated to maintain the value of its capital; will protect itself against foreign exchange risks; will build up a staff suitable to its objectives; will follow a sound reserves policy; will have an annual independent audit, etc. The Bank and IFC consider the Statement adequate and appropriate. Any amendment of the Statement will require prior approval of the Bank.

KDFC's Prospects

19. Business and Profit Prospects. In view of the expanding economy and the demand for medium and long-term industrial financing in the private sector, KDFC's business prospects are good. The steady growth in Korea's exports of manufactured goods from a few million dollars in 1959 to over \$150 million in 1966, and the sustained growth in 1967, point to a continuing demand for resources to expand capacity. Manufacturing industries have large foreign exchange requirements for machinery and equipment. With the proposed loans from the Bank and AID, KDFC would be in a favorable position to play an important part in financing the expansion of private enterprise in Korea, including Korea's export industries. Current applications from the private sector for loans from KRB and MIB are far in excess of their lending capacity. In spite of the conversion of some part of its Won resources, KDFC's commitment of the proposed loans from the Bank and AID against foreign exchange requirements is likely to be relatively rapid. The rate of commitment may be limited more in the early stages by KDFC's capacity to process applications than by the volume of business available.

20. Although the high level of interest rates reflects in part a history of inflation, it also reflects the strong demand for capital and its high productivity. KDFC proposes charging initially interest rates of 20% per annum on its domestic currency loans, and 10% on its foreign currency loans. KDFC's financial position will be strengthened by the proposed Government loan (paragraph 11 b.) on which a spread at the rate of 6% per annum will be available at once and until the funds are invested long term; thereafter the spread will be of the order of 16%. Given the expected rapid commitment of its initial resources, KDFC is expected to yield a satisfactory return very soon.

21. Taxation and Position of Foreign Investors. KDFC will be subject to national taxation, the current rates of which are as follows:

- a. 0.84% of gross receipts, as business tax; and
- b. 22% - 38.5% of profits, as corporate income tax, depending on the amount of profit.

22. However, the foreign investment in KDFC, and KDFC itself, are expected to receive the benefits of authorization under the Foreign Capital Inducement Law (FCIL) of August 1966. Accordingly, for five years KDFC's profits will be free of tax in proportion to the foreign participation in KDFC's share capital; and for another three years thereafter, tax in the same proportion will be at half the applicable rate.

23. Receivers of dividends are normally taxed at the rate of 12% of the amount of the dividend. If, as is expected, KDFC and the foreign investments receive the benefits of authorization under FCIL, foreign shareholders will not be taxed on the dividends they receive for five years; and for the next three years they will be taxed at one-half the normal 12% rate. FCIL also provides that remittance of dividends and repatriation of capital shall be guaranteed; however, repatriation may begin only after two years of operations and may take place at the rate of not more than 20% annually. The Government has agreed to an exception from the existing law, whereby IFC and the original private foreign investors, if they take up shares originally subscribed by IFC, or pursuant to arrangements with IFC, will have special rights with respect to the repatriation of the proceeds of sales of shares in KDFC.

24. Dividends and Reserves. As noted in the policy statement, KDFC will seek profits high enough to protect the value of its capital against erosion, to set aside prudent reserves and to pay reasonable dividends. A conservative reserves policy will guide decisions on the pay-out of profits. A satisfactory dividend should be possible in two to three years.

Audit

25. The accounts of KDFC will be audited annually by independent public accountants, in accordance with internationally accepted accounting principles.

Relations with KRB and MIB

26. The Government will state, in a letter in terms already agreed, (Annex VII), that KRB and MIB are, in accordance with the spirit of the Acts which created them, institutions of last resort so far as private enterprise generally is concerned, and that the Government expects KDFC to become the principal source of medium-term and long-term finance for private industry in Korea.

IFC/DFC

January 2, 1968

KOREA DEVELOPMENT FINANCE CORPORATION

List of Korean Shareholders

	<u>No. of Shares</u>
<u>I. FKI Members & Public</u>	
Ssangyong Cement Co., Ltd.	6,475
Hankuk Glass Industry Co., Ltd.	6,473
Hankuk Fertilizer Co., Ltd.	5,960
Jae Ho Chung	5,281
Pan Bon Spinning Co., Ltd.	5,000
Tong Yang Cement Co., Ltd.	4,768
Lucky Chemical Co., Ltd.	4,473
Korea Nylon Co., Ltd.	4,000
Hyun-Dai Const. Co., Ltd.	4,000
Hong Jai Cho	3,576
Yong Poong Trading Co., Ltd.	2,700
Korea Cement Mfg. Co., Ltd.	2,384
Korean Explosives Co., Ltd.	2,000
Gold Star Co., Ltd.	2,000
Taesung Lumber Ind'l Co., Ltd.	1,200
Chosun Silk Textile Co., Ltd.	1,200
Hankuk Wool Textile Co., Ltd.	1,200
Chunnam Textile Co., Ltd.	1,192
Samho Trading Co., Ltd.	1,192
Jedong Industrial Co., Ltd.	1,192
Duck Kyun Shin	1,192
Sam Yang Co., Ltd.	1,184
Kyungsong Spinning Co., Ltd.	1,104
Inchon Ironworks Co., Ltd.	1,080
Hanil Synthetic Fiber Co., Ltd.	1,080
Ilssin Industrial Co., Ltd.	1,000
Ilshin Industrial Co., Ltd.	1,000
Kyung Dong Sull	1,000
95 shareholders holding less than 1,000 shares each	<u>9,094</u>
	84,000
<u>II. Commercial Banks</u>	
The Cho Heung Bank	9,200
The Commercial Bank of Korea	9,200
The First City Bank of Korea	9,200
The Hanil Bank	9,200
The Bank of Seoul	<u>3,200</u>
	40,000

III, <u>Insurance Companies</u>	<u>No. of Shares</u>
Korea Re-Insurance Co., Ltd.	10,000
Dae Han Life & Insurance Co., Ltd.	2,400
Dong Bang Life Insurance Co., Ltd.	2,400
Dae Han Educational Insurance Co., Ltd.	2,400
Dong Yang Fire & Marine Insurance Co., Ltd.	2,100
Shin Dong-A Liabilities Insurance Co., Ltd.	2,100
Dae Han Fire & Marine Insurance Co., Ltd.	2,100
The Kukje Fire & Marine Insurance Co., Ltd.	2,100
The Koryo Fire & Marine Insurance Co., Ltd.	2,100
The First Fire & Marine Insurance Co., Ltd.	2,100
Haedong Fire & Marine Insurance Co., Ltd.	2,100
The An-Kuk Fire & Marine Insurance Co., Ltd.	2,100
The Eastern Fire & Marine Insurance Co., Ltd.	2,100
Pan Korea Fire & Marine Insurance Co., Ltd.	2,100
Koryo Life Insurance Co., Ltd.	600
The First Life Insurance Co., Ltd.	600
Heung Kuk Life Insurance Co., Ltd.	600
	<hr/> 40,000
TOTAL	<hr/> <hr/> 164,000

IFC - DFC

November 22, 1967

Annex II

KOREA DEVELOPMENT FINANCE CORPORATION

Proposed Foreign Subscriptions

	<u>In \$ '000</u>	
Bank of America (or affiliate)	175	
First National City Bank (or affiliate)	175	
United California Bank (or affiliate)	140	
Irving Trust Company (or affiliate)	<u>125</u>	
		615
Deutsche Bank A.G.	125	
The Chartered Bank	100	
Banca Commerciale Italiana	<u>100</u>	
		325
The Industrial Bank of Japan, Limited	155	
The Bank of Tokyo, Ltd.	<u>155</u>	
		<u>310</u>
		<u>1,250</u>

IFC/DFC

November 29, 1967

KOREA DEVELOPMENT FINANCE CORPORATION

Curriculum Vitae of Mr. C. S. Hong

Full Name: Chai Sun Hong

Date of Birth: June 15, 1904

Address: 64-5, 2-ka, Zuh-Dong, Seoul

Education: Graduate of The Foreign School of Law, Seoul
National University

Present Position:

1. Chairman of boards of directors:
 - (a) Ssang Yong Cement Ind. Co., Ltd.
 - (b) The Korea Fire & Marine Insurance Co., Ltd.
 - (c) Taipyung Textile Co., Ltd.
 - (d) Keum Sung Trading Co., Ltd.
2. President of:
 - (a) Keum Sung Textile Co., Ltd.
 - (b) Korean Federation of Industries (formerly
Korean Businessmen's Association)
3. Chairman of Korea Development Finance Corporation

IFC/DFC

November 29, 1967

KOREA DEVELOPMENT FINANCE CORPORATION

List of Korean Directors
(Elected on April 20, 1967)

<u>Name</u>	<u>Term</u> (Years)
<u>I. Representing the Promotors Group and other private shareholders</u>	
1. Chai Sun Hong (Sangyong Cement Co., Ltd.)	2
2. Chin Hyung Kim (President, KDFC)	2
3. Tai Sup Choi (Hankuk Glass Industry Co. Ltd.)	1
4. In Hoi Koo (Lucky Chemical Co., Ltd.)	1
5. Yong Wan Kim (Kyungsong Spinning Co., Ltd.)	1
6. Jae Ho Chung (Samho Textile Co., Ltd.)	1
<u>II. Representing Commercial Banks</u>	
1. Chong Kun Moon (President, Cho Heung Bank)	2
2. Byoung Soon Lee (Deputy Governor, KRB)	1
<u>III. Representing Insurance Companies</u>	
1. Pil Suk Lee (President, The Kukje Fire and Marine Insurance Co., Ltd.)	2

IFC/DFC

November 29, 1967

KOREA DEVELOPMENT FINANCE CORPORATION

Curriculum Vitae of Mr. C. H. Kim

Full Name: Chin Hyung Kim
Date of Birth: October 26, 1905
Home Address: 432, Dongbu-dong, Sunsan-myun, Sunsan-gun,
Kyong Sangbuk-do
Present Address: 281 Pyongchang-dong, Sodemoon-ku, Seoul, Korea

Education and
Personal Experience:

March 1922	Graduated from the Pusan Public Commercial School
March 1926	Graduated from Yamaguchi Commercial College in Japan
April 1926	Entered Chosun Industrial Bank
March 1948	Managing Director of Korean Foreign Exchange Bank
March 1948	Vice President of Korean Foreign Exchange Bank
February 1949	Director of Bank of Korea
June 1950	Resident Director of Bank of Korea in Tokyo
May 1956	President of Korea Agricultural Bank
December 1956	Governor of Bank of Korea
April 1960	Resigned from Bank of Korea
March 1964	Director of Chunusa Co. Ltd.
June 1964	President of Daesung Lumber Industrial Co. Ltd.
December 1966	Resigned from Daesung Lumber Industrial Co. Ltd. and Chunusa Co. Ltd.
December 1966	Vice Chairman of Promoters' Association for Korea Development Finance Corporation
April 1967	Elected President of Korea Development Finance Corporation

IFC/DFC

November 29, 1967

Statement of Investment and Operational Policies

(Adopted by the Board of Directors on April 25, 1967)

The Korea Development Finance Corporation, whose object is to promote the expansion of private enterprise in the Republic of Korea, will be guided by the policies set forth below:

I. The Scope of Investment Activities

- 1) KDFC will invest only in productive enterprises. While its primary activity will be manufacturing and processing industry, it may invest also in other types of enterprises, including transport, tourism, and large-scale commercially oriented agriculture. However, trade, real estate and small-scale agriculture will be excluded.
- 2) KDFC will finance only private enterprises which are properly organized and managed. KDFC will not invest in undertakings which are Government-owned and operated, but a Government holding of not more than 15% of the voting stock of a private enterprise shall not make such enterprise ineligible for financial assistance from KDFC. KDFC will finance both new enterprises and existing ones for expansion or improvement.
- 3) In its operations, KDFC will give due regard to the Government's general economic plans and policies. The following categories of industries will receive high priority, in accordance with the Government economic policies and objectives:
 - a) export industries;
 - b) import-substitute industries;
 - c) industries producing raw materials necessary for production of export commodities and import-substitutes;
 - d) indigenous local industries which have special advantage in comparative costs and potential marketability in foreign markets;
 - e) participation or assistance in the turn-over of the Government-owned industries to private ownership.
- 4) KDFC will assist private enterprises in the following ways:
 - a) medium and long-term loans;
 - b) equity participation (through underwriting, conversion rights, direct participation in share capital or otherwise);

- c) guarantee of payment for machinery and equipment imported or otherwise;
 - d) guarantee and underwriting of corporate securities;
 - e) technical and managerial consultant services; and
 - f) any other appropriate manner.
- 5) KDFC will seek through its operation, to broaden the ownership of private securities in Korea.
 - 6) KDFC's financial assistance will be primarily for expenditures for fixed assets. KDFC will, however, consider requests for permanent working capital in conjunction with its financial assistance for such capital expenditures.
 - 7) KDFC will study periodically the trend of over-all industrial development and investment opportunities in the private sector in cooperation with research institutes for promotion of new enterprises or expansion of the existing ones.

II. Basis for Investment Decisions

- 8) KDFC will make investment decisions only on the basis of sound investment criteria and standards, and will provide financial assistance only to those projects which are financially and economically sound and technically feasible. Special attention will be given to the ability of management and the profitability of the enterprise.

III. Diversification of Portfolio

- 9) KDFC will diversify its portfolio in order to maintain a reasonable level of risk.
- 10) KDFC will not provide financial assistance of less than the Won equivalent of \$50,000. The maximum financial commitment in whatever form, including loan, share capital or guarantee or any combination thereof, that KDFC may make to any single enterprise will not exceed 15% of the total of KDFC's paid-in capital, free reserves and Government loan of 1967.
- 11) KDFC will not commit to any single enterprise in form of share capital more than 10% of KDFC's paid-in capital and free reserves. The aggregate equity investment of KDFC at any time will not exceed the total of its paid-in share capital and free reserves.
- 12) In undertaking large-size projects, KDFC will seek cooperation with other financial institutions, both domestic and foreign.

IV. Turn-over of Portfolio

- 13) In order to recover its resources for new commitments and to encourage widespread ownership of private securities, KDFC will revolve its portfolio whenever it can do so on satisfactory terms. In selling an investment it will pay due regard not only to its own interests but also to the interests of other participants in such investment, as also to the interest of the concern whose shares are involved.

V. Relationship with Enterprises Financed

- 14) KDFC will not take a controlling interest in any enterprise in which it has invested, or any other interest which would give it primary responsibility for management, except that in the case of jeopardy, it may take such action as may be necessary to protect its interest. To this end it will not take up more than 25% of the share capital of an enterprise, except as the result of an underwriting commitment undertaken in the expectation that the investment would in fact be within the limit cited.
- 15) In accordance with normal banking practice, KDFC will require its borrowers to provide and to maintain adequate security, to keep records and accounts in accordance with sound accounting practices, and to furnish whatever information on their operations and accounts KDFC deems desirable. KDFC will take the right to inspect the enterprises it finances as well as their operations and accounts.
- 16) Business secrets and other information furnished by applicants or clients will be treated as confidential.

VI. Financial Guide-Lines

- 17) KDFC will lend and invest its resources in such a way as to maintain the value of its capital. KDFC will pass to its clients any foreign exchange risk it assumes or find other suitable means to cover it.
- 18) KDFC will not incur any debt (not including as debt the loan made by Korean Government in 1967) in excess of three times the aggregate of its paid-in capital, free reserves and the 1967 Government loan outstanding.
- 19) KDFC will maintain accounting records adequate to reflect its business operations in accordance with sound and generally accepted international accounting practices and standards. KDFC will employ qualified and independent public accountants to audit its books and certify the accounts annually.

VII. Profits and Their Distribution

- 20) KDFC will seek to develop earnings sufficient to cover expenses and taxes, to provide reserves adequate to the size and risks of its portfolio and to protect its equity against erosion and to pay satisfactory dividends. It will seek profits on its equity investments and will impose interest rates, fees and other charges for its loans and services which will permit it to achieve that level of profitability. It will build and maintain reserves consistent with sound financial management. It will set aside each year from net income before tax the amount required by law as the legal reserve. In addition, it will accumulate other reserves, including reserve for losses, as considered prudent by the Board of Directors.

VIII. Staff

- 21) KDFC will build up a technically qualified staff capable of carrying the responsibilities which KDFC's objectives create, and able to provide the services to clients which those objectives call for.

IX. Revision of Policies

- 22) Any proposal to revise this Statement of Investment and Operational Policies shall be considered by the Board of Directors only after each member has been given an adequate opportunity to study and comment on the proposal, and it shall be approved at a meeting of the Board of Directors by two-thirds of all directors.

IFC/DFC

November 29, 1967

KOREA DEVELOPMENT FINANCE CORPORATION

Proposed Government Statement on the
Relations between KDFC and KRB/MIB

[Date]

International Finance Corporation
1818 H Street, N.W.
Washington, D.C. 20433

Gentlemen:

We record in this letter the understanding reached between us regarding the roles of the Korean Reconstruction Bank (KRB) and Medium Industry Bank (MIB) on the one hand, and the proposed Korea Development Finance Corporation on the other hand.

The Korea Development Finance Corporation is being set up as a privately owned and managed company to provide medium and long-term capital to private enterprises. The KRB is the principal vehicle for providing finance to government industrial projects and public bodies, and the MIB is the primary institution for financing smaller scale industries, as defined in its Act. So far as private enterprise generally is concerned KRB and MIB are, in accordance with the spirit of the Acts which established them, lenders of last resort. Accordingly we expect KDFC to become the principal source of medium and long-term capital for private industry in Korea.

We believe that the KDFC will thus play an important role in promoting the economic development of the country and that its activities and those of KRB and MIB will be complementary.

Yours faithfully,

Minister of Finance

IFC/DFC

November 29, 1967